

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-5004

To be Argued By
FREDERICK H. BLOCK

United States Court of Appeals

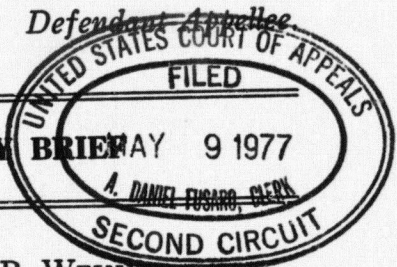
SECOND CIRCUIT

HOUSEHOLD FINANCE CORPORATION,
Plaintiff-Appellant,
—against—

KEITH ORIN DANNS, a/k/a KEITH O. DANNS,
a/k/a KEITH DANNS,

Defendant-Appellee

APPELLANT'S REPLY BRIEF MAY 9 1977



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HOUSEHOLD FINANCE CORPORATION,

Plaintiff-Appellant,

—against—

KEITH ORIN DANNS, a/k/a KEITH O. DANNS,
a/k/a KEITH DANNS,

Defendant-Appellee.

APPELLANT'S REPLY BRIEF

I

The real controversy before this Court is as to the intent of Congress in enacting the Celler Amendment in 1960 (Pub. L. 86-621) and the 1970 Amendment (Pub. L. 91-467).

We contend that Congress intended to bar a discharge as to an obligation refinanced through the use of a false financial statement.

The appellee and the *amicus** urge that the dishonest debtor should be granted a discharge for all but the fresh cash.

The following is undisputed in the briefs before this Court:

1. The highest courts of all the states which considered the issue between 1960 and 1970 have uniformly supported

*We discuss the *amicus* brief herein notwithstanding the fact that we have moved to strike it pursuant to § 28 of the Rules of this Court Supplementing the Federal Rules of Appellate Procedure.

our contention that the Celler Amendment was intended to make the entire obligation non-dischargeable (Appt's Br. pp. 12-14).

2. Collier (Appt's Br. pp. 13-14) and Professor Schuchman in his article cited in appellant's brief at page 18 likewise support our view of the congressional intent.

3. The plain language of the statute, 11 U. S. C. 35(a)(2), supports our contention. See in addition to *Matter of Shade* and *Matter of Clem* set forth in the addendum to appellant's main brief, the decision of Judge Newman of the District Court for Connecticut in *Beneficial Finance Company of Norwalk vs. Fields*, decided March 21, 1977, annexed hereto for the convenience of the Court.*

4. The 1970 Amendment which gave the bankruptcy courts exclusive jurisdiction of the dischargeability of certain debts, worked no substantive change (Collier, Appt's Br. p. 15) and did not justify the ignoring by the federal courts of the state decisions (Professor Schuchman's articles, Appt's Br. p. 17). Incidentally the Amendment bespoke no lack of confidence in the state courts because the state courts are still permitted to determine the dischargeability of certain debts. *New York v. Wilkes*, — N.Y. 2d — (decided April 28, 1977, N. Y. L. J. May 2, 1977, front page).

Notwithstanding the foregoing, the opposing briefs rely on the views of two Bankruptcy Judges, Lee and Townsend, and on the few federal decisions whose fallacies we have pointed out in our main brief, pp. 19-24.

*The major point in Judge Newman's opinion is his view, coinciding with ours, as to the intent of the Celler Amendment.

II

The *amicus* brief relies heavily on the unreported decision of Judge Weinstein in *In Re Stanzione* (Br. pp. 20, 22) which was not discussed in appellant's main brief. Appellant's main brief, however, did discuss the cases which were the underpinnings of Judge Weinstein's decision and demonstrated their unsoundness. In particular we now point out that Judge Weinstein in adopting the pecuniary loss theory, relied on *Fuhrman*. Since *Fuhrman* applied the New York law of damages, i.e. the law of the state in which the court sat, it is difficult to understand how that can be reconciled with Judge Weinstein's desire to achieve uniformity of federal decision.

III

In the final analysis, we call this Court's attention to what has been overlooked in the opposing briefs, namely that relief from the burden of debt is not for the dishonest debtor. In this connection, the Supreme Court of the United States observed in *Bruning vs. United States*, 376 U. S. 358, 361 (1964): "§ 17 is not a compassionate section for debtors." And in *New York v. Wilkes, supra*, the Court upheld denial of a discharge in a situation completely different from that at bar and said in pertinent part:

"Discharge in this case, then, would be out of harmony with the basic purpose of the Bankruptcy Act, which is to relieve honest debtors of the crushing burdens of heavy debt (see *Brown v. O'Keefe*, 330 U.S. 598, 606)".*

*See also Collier, cited in appellant's brief, p. 19.

The reliance in the opposing briefs on *Gleason v. Thaw*, 236 U. S. 558 (1915) and *Lines v. Frederick*, 400 U. S. 18 (1970) is, therefore, completely misplaced.

Accordingly, we respectfully submit that this Court should not act as if it were the legislature, as the *amicus* brief suggests. It should rule on the narrow issue presented by this record in accordance with the plain language of the statute in light of its legislative history and the authorities we have cited. The fresh cash doctrine should be rejected.

CONCLUSION

For the foregoing reasons and for the reasons set forth in appellant's main brief, the judgment below should be reversed.

Respectfully submitted,

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ADDENDUM

AD1

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

In the Matter of
WILLIAM E. FIELDS and
DOROTHY M. FIELDS,
Bankrupts

BENEFICIAL FINANCE COMPANY
OF NORWALK

v.

WILLIAM E. FIELDS and
DOROTHY M. FIELDS

Bankruptcy
Nos. B-75-443
and B-75-444

MEMORANDUM OF DECISION

Appellant Beneficial Finance Company of Norwalk (BFC) appeals from the decision of Bankruptcy Judge Trevethan rendered on March 5, 1976, discharging the appellees-bankrupts from repayment to BFC of all but \$205.42 of a credit obligation of \$2,081.21. Appellant contends that under § 17a(2) of the Bankruptcy Act, as amended in 1960, 11 U. S. C. § 35(a)(2), the Fields' full obligation to BFC is non-dischargeable.

On May 24, 1974, William and Dorothy Fields applied to BFC for a loan of \$2,448. In support of their application, they were required to execute a financial statement listing all of their debts. The Fields prepared such a statement and certified to its accuracy. In this statement, they listed only \$2,572.52 of unsecured indebtedness. BFC approved the loan application, and loaned the Fields \$2,448. At the time this loan was made, the Fields were in default

on payments to BFC of a prior loan obligation. The new loan was used, in part, to refinance this prior debt. After payment of the prior debt, the Fields received \$205.42 in cash from the new loan.

On June 2, 1975, the Fields filed for bankruptcy. Included in the schedule of obligations filed by the Fields was the May, 1974, debt owed to BFC, which by then had been reduced to \$2,081.21. Also included in the schedule was \$19,000 of indebtedness previously omitted from the financial statement submitted to BFC. BFC objected to discharge of the May, 1974, debt, claiming that under § 17a(2) of the Bankruptcy Act discharge of a fraudulently obtained renewal of credit is barred.

After a trial on BFC's complaint, the Bankruptcy Court sustained BFC's claim that the Fields had submitted a false financial statement with intent to deceive BFC, and also found that BFC had relied upon the false statement in approving the loan. Memorandum of Decision 1. The judge held, however, that only the \$205.42 received by the Fields as "fresh money" was non-dischargeable. The judge accordingly released the Fields from the remainder of the indebtedness on the loan.

The issue before this Court is whether the Bankruptcy Court's interpretation of § 17a(2) of the Bankruptcy Act 11 U. S. C. Sec. 35 (a)(2) was correct, or in other words whether a lender who agrees to refinance an existing loan in reliance upon a borrower's intentionally false financial statement is entitled to recover all of the new loan, or only the part in excess of the old loan after the debtor's bankruptcy.

Section 17a(2) of the Bankruptcy Act, 11 U. S. C. § 35a (2), provides, in pertinent part:

A discharge in bankruptcy shall release a bankrupt from all of his provable debts . . . except such as

... are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or *obtaining an extension or renewal of credit* in reliance upon a materially false statement in writing . . . (emphasis supplied).

The plain language of the statute appears to prohibit the discharge of the full debt, *i.e.*, "liabilities," stemming from fraudulently obtained credit renewals. Despite this apparent clarity, the bankruptcy judge construed the statute to allow discharge of the debt from the loan renewal, and to forbid only the discharge of the debt arising from the "fresh cash" advanced at the time of the consolidation of the old debt and the new loan.

This interpretation is understandable, since the application of § 35a(2) to loan renewal transactions has not been uniform. As appellant's brief points out, prior to 1960, courts divided over whether a creditor in a transaction such as the one at issue in this case was entitled to receive the entire indebtedness, or only the "fresh cash" advanced the debtor. Compare *Local Indus. Finance Co. v. McDougale*, 404 S. W. 2d 789 (Ky. Ct. App. 1966), and cases cited therein, with *Household Finance Corp. v. Christian*, 8 Wis. 2d 53, 98 N. W. 2d 390 (1959). According to one commentator, before the 1960 amendments to the Bankruptcy Act, most of the states had taken the view that the creditor was entitled to recover the full debt, while a "respectable minority of the states" held that his recovery was limited to the "fresh cash." Schuchman, *The Fraud Exception in Consumer Bankruptcy*, 23 Stan. L. Rev. 735 (1971).

An examination of the legislative history of § 35a(2) reveals that Congress intended to eliminate this confusion with the 1960 amendments to the Bankruptcy Act. The addition to the statute of the term "extension or renewal

of credit" expressly brought loan renewal transactions within the statute's general prohibition of discharge. The Senate Report described the purpose of the amendment to § 35a(2):

The purpose of this amendment is to assure that although the obtaining of money or property on credit through the issuance of a false financial statement is no longer to be ground for denial of a discharge to a nonbusiness bankrupt, *any obligation incurred* as a result of such a statement to be nondischargeable under section 17. (emphasis supplied).

1960 U. S. Code Cong. & Admin. News 2956, quoting S. Rep. No. 1688, 86th Cong., 2d Sess. (1960); see also Hearing on H. R. 106 before a Subcommittee of the Senate Committee on the Judiciary, 85th Cong. 2d Sess. 102 (1958); 1960 U. S. Code Cong. & Admin. News 2957 (Ltr. of J. Glassman to Sen. Eastland).

This amendment to § 35 was intended to be part of a compromise between the rights of creditors and the rights of bankrupt debtors. The amendment strengthens the rights of creditors who have made loans in reliance on false statements, while another amendment to the Bankruptcy Act enacted the same year curtails the ability of creditors to block discharge of a non-commercial bankrupt's debts on the ground of fraud. See 11 U. S. C. § 32(c)(3). As Professor Schuchman stated in his study of consumer bankruptcy, "... in consideration for lenders' losing the right to bar a discharge to consumer-bankrupts, the final version of the 1960 amendments to the National Bankruptcy Act also added to section 17 a(2) a provision ... that if an extension or renewal of credit was obtained in reliance upon a materially false written statement, the full obligation (not just the cash proceeds of the renewal or refinancing) would

not be dischargeable in bankruptcy." Schuchman, *supra* at 740 (citations omitted).

Since enactment of the amendment to § 35, many of the jurisdictions where the minority view had previously prevailed have reversed their position, and now recognize that the creditor is entitled to pursue the debtor for the full indebtedness on a fraudulently obtained loan renewal. Compare *Federal Finance Co., Inc. v. Merkel*, 65 Wash. 2d 379, 397 P. 2d 436 (1964) with *Household Finance Co. v. DeShazo*, 57 Wash. 2d 771, 359 P. 2d 1044 (1961); *First Credit Corp. v. Wellnitz*, 21 Wis. 2d 18, 123 N. W. 2d 519 (1963), with *Household Finance Co. v. Christian*, 8 Wis. 2d 53, 98 N. W. 2d 390 (1959); *Liberal Finance Corp. v. Holley*, 157 So. 2d 376 (La. App. 1963), with *Personal Finance Co. v. Murphy*, 53 So. 2d 421 (La. App. 1951).

Since the decision appealed from is inconsistent with both the language and legislative history of § 35a(2), the case is remanded with instructions to enter an order consistent with this opinion.

Dated at New Haven, Connecticut, this 21 day of March, 1977.

/s/ JON O. NEWMAN
Jon O. Newman
United States District Judge